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## OPEC: A Saudi-Iranian Rivalry

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**An Intelligence Assessment**

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# **OPEC: A Saudi-Iranian Rivalry**

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**An Intelligence Assessment**

This paper was prepared by [redacted]  
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from [redacted] OGI, and the Office of Near  
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queries are welcome and may be directed to the  
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**OPEC:  
A Saudi-Iranian Rivalry**

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**Key Judgments***Information available  
as of 28 August 1986  
was used in this report.*

The recent OPEC agreement represents a temporary lull in the struggle over oil policy between Saudi Arabia and Iran. Saudi interest in a stable long-term market for their oil with relatively low prices contrasts sharply with the more immediate Iranian need for high prices for economic recovery and development. The ongoing struggle for power in the Persian Gulf region, including influence over oil market conditions, has serious implications for the West. As long as the Saudis remain the undisputed leader within OPEC, oil prices will probably remain relatively low over the next few years. If Iran emerges as the clear victor in the war with Iraq, Tehran could also emerge as a dominant force in the world oil market.

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With the recent OPEC decision to restrain production, we expect prices to remain near their current level of about \$15 per barrel over the next few years, barring a major supply disruption. A breakdown in producer discipline, however, could force prices even lower—perhaps well below \$10 per barrel. In the meantime, uncertainty about producer intentions will continue to cause price volatility.

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Over the next several years, we expect that prospects for low oil prices will work in favor of a reemergence of conditions for market control for Persian Gulf producers. We believe that Saudi Arabia and Iran will have the powerful combination of oil wealth and military might to be particularly influential in Persian Gulf affairs. Coupled with the conditions that gave OPEC producers market power in the past—especially strong demand growth and limited growth in supplies from other countries—the rivalry between Saudi Arabia and Iran will become even more heated:

- As long as stalemate continues—or the war ends in a draw—we believe the Saudis will have the upper hand. Riyadh will push for steadily rising prices, but well below levels reached as recently as last year. Saudi long-term oil objectives favor a stable energy environment to boost oil demand and slow oil and alternative supply development in high-cost areas like the United States. This would clearly increase Western import dependence on low-cost suppliers like the Saudis.

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- A clear Iranian victory, however, could shift the balance of power in the Gulf region and the oil market, especially if Tehran is able to control or substantially influence Iraqi oil marketing policies. Tehran's market power would be even greater if it were able to influence Kuwaiti oil policy—a likely possibility with a major victory in the war. Taken together, Iran, Iraq, and Kuwait have about 7 million b/d of oil productive capacity—enough to seriously challenge Riyadh's dominance.

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The continuing confrontation between Saudi Arabia and Iran heightens the risk of intraregional frictions and internal strife arising from conflicting oil policies. These conditions, in our view, combined with economic problems and acts of terrorism, will continue to pose potential threats to the free flow of oil. Despite the near-term benefits, if low prices continue for several years, there will be a greater risk that any supply disruptions will increase the economic and security consequences for the West.

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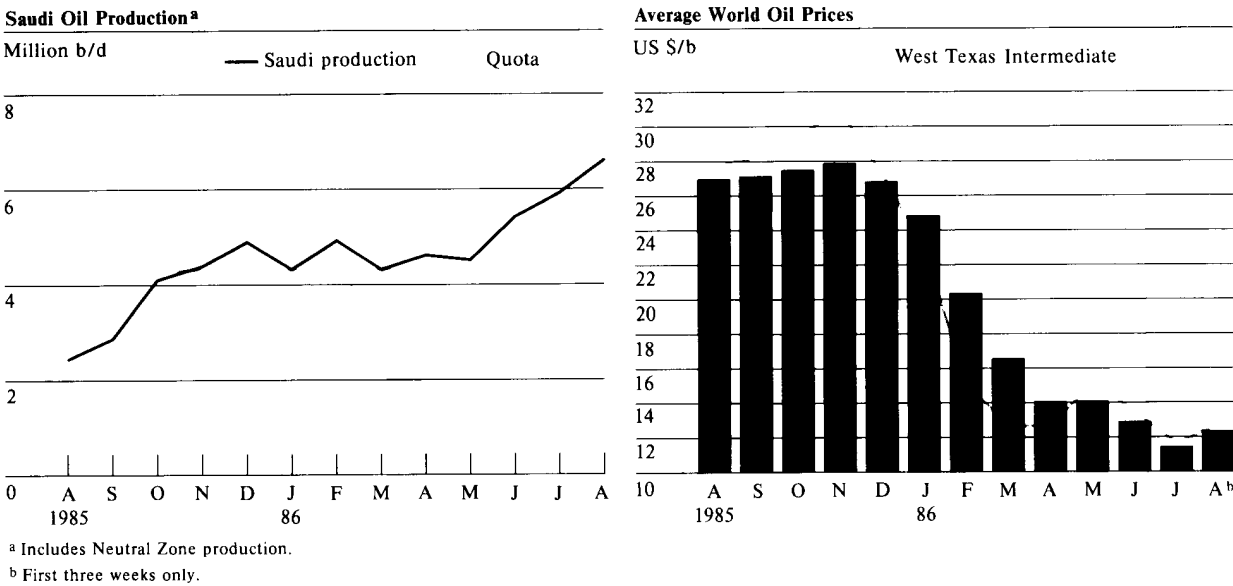
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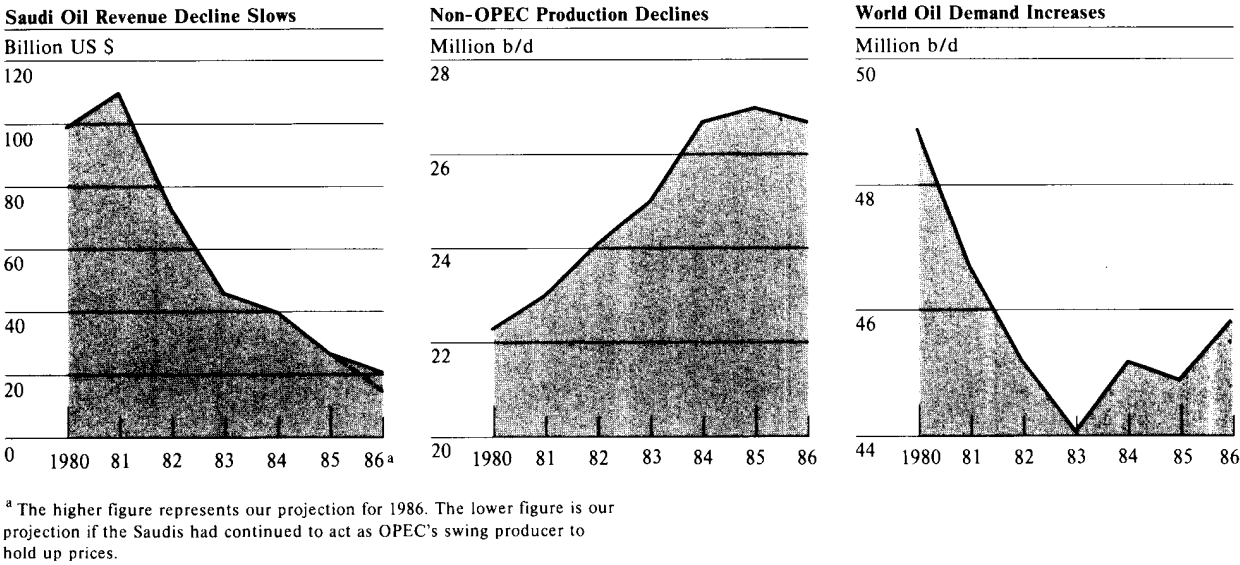
Figure 1  
Saudi Oil Production and Average World Oil Prices



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Figure 2  
Saudi Arabia's Successful Offensive



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## OPEC: A Saudi-Iranian Rivalry

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### Recent Developments

For the several years preceding the recent price collapse, Riyadh's willingness to act as OPEC's swing producer and Tehran's preoccupation with its war with Iraq served to mask what has traditionally been sharp conflict between the two over oil policies (see inset, "Saudi Arabia and Iran: OPEC Rivalry"). Saudi Arabia's decision in September 1985 to abandon its role as the group's swing producer and increase market share triggered this year's oil price plunge (see figure 1). The Saudi oil policy decision to raise market share even at the expense of sharply lower prices was designed to raise their near-term revenues, force other producers to reduce output, and ensure a long-term market for Saudi oil. The effort was largely successful. Riyadh boosted production from a 20-year low of about 2.4 million b/d in August 1985 to nearly 7 million b/d a year later. During this period, Saudi revenues increased over what they would have been, non-OPEC output declined slightly, and non-Communist oil demand increased by about 2 percent above levels of a year earlier (see figure 2). Although not a primary objective of the Saudis, Iran suffered substantial oil revenue losses—hurting its ability to fund the war against Iraq.

In our view, the Saudis probably wanted to see prices stabilize at about \$15 per barrel. This price would have enabled Riyadh to produce about 4.5 million b/d and satisfy most of its objectives. Because the other producers refused to cut production back to their OPEC quotas to make room for increased Saudi output, prices fell even further. We estimate that, in early August, the average world oil price fell to \$11 per barrel, compared with about a \$27 per barrel average for all of last year.

The sharp drop in oil revenues and prospects of even lower prices were the driving factors behind the OPEC agreement to adopt an Iranian production-sharing scheme. The members agreed to limit total OPEC crude production to 16.65 million b/d during September and October, some 3-4 million b/d below

Table 1

Million b/d

### OPEC: Crude Oil Production, 1986

	Quota	1st Qtr	2nd Qtr	July	August	Productive Capacity <sup>a</sup>
<b>Total</b>	<b>16.7</b>	<b>17.7</b>	<b>18.8</b>	<b>20.0</b>	<b>20.5</b>	<b>26.7</b>
Algeria	0.66	0.7	0.7	0.7	0.7	1.1
Ecuador	0.23	0.3	0.3	0.3	0.3	0.3
Gabon	0.14	0.2	0.2	0.2	0.2	0.2
Indonesia	1.19	1.3	1.3	1.3	1.3	1.5
Iran	2.30	2.3	2.2	2.2	2.0	3.4
Iraq	1.80 <sup>b</sup>	1.8	1.7	1.8	1.8	1.9
Kuwait <sup>c</sup>	0.90	1.3	1.5	1.8	1.8	1.6
Libya	0.99	1.0	1.1	1.1	1.1	1.6
Nigeria	1.30	1.4	1.6	1.5	1.5	1.8
Qatar	0.28	0.3	0.3	0.4	0.4	0.6
Saudi Arabia	4.35 <sup>c</sup>	4.4	4.8	5.9	6.6	8.5
UAE	0.95	1.2	1.4	1.3	1.3	1.7
Venezuela	1.56	1.6	1.6	1.6	1.6	2.5

<sup>a</sup> Available 90-day capacity; includes natural gas liquids.

<sup>b</sup> Current Iraqi export capacity. Under new quota system, Iraq is not bound by a specific output quota.

<sup>c</sup> Includes production from the Neutral Zone.

recent production levels (see table 1). The bulk of the cutback will be borne by Saudi Arabia, Kuwait, and the UAE. The agreement centered on Tehran's withdrawal of its strong demands that prices be raised to \$28 per barrel with a sharp cutback in OPEC output and that Iraq's quota not be raised. Under the agreement, OPEC essentially returns to its October 1984 production allocation scheme. Iraq does not have a quota, and a slight increase was given to Ecuador. OPEC is scheduled to meet again in October to map out its course for the future.

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### **Saudi Arabia and Iran: OPEC Rivalry**

*The roots of Saudi Arabian and Iranian contention for leadership within OPEC extend back to the days of the Shah. Although a shared interest in maintaining the effectiveness of OPEC generally has led to cooperation and compromise in cartel decisions, differences in outlook and policies have charged the relationship with mistrust and competition for influence. The Saudis and Iranians frequently have led contending factions within OPEC: Tehran at the vanguard of the price hawks and Riyadh speaking for the more moderate faction. Even under the Shah, Tehran suspected that a secret deal with Washington was behind Riyadh's price restraint, while the Saudis believed Iran's price policies were linked to its extra-territorial ambitions.* [ ]

*Besides the recent battle of wills, Iranian-Saudi strains have led to direct confrontations in OPEC on several occasions:*

- *In the spring of 1974, the Saudis threatened an oil auction to bring down oil prices against Iran's will. Instead, they raised prices retroactively to stay in line with the rest of OPEC.*
- *In the fall of 1975, the Saudis won a battle over Iranian-led opposition to confine a price increase to 10 percent. After engineering price freezes in several*

*subsequent meetings, Riyadh—along with the UAE—split with the rest of OPEC in December 1976 by raising prices 5 percent instead of 10 percent. An effort to force down other OPEC prices by expanding production failed.*

- *In the spring of 1983, the Saudis led a move to decrease the OPEC benchmark price from \$34 to \$29 per barrel over Iran's protest. At Tehran's insistence, a commission was set up to examine whether long-term oil revenues would be greater at a higher price, as argued by Iran.* [ ]

*Despite its leading role in orchestrating support for higher oil prices, Iran has avoided contesting the Saudis for the role of swing producer. Indeed, the Iranians have insisted that the Saudis shoulder this burden, and Riyadh cooperated until late last year. In fact, after raising their production to 9.5 million b/d to dampen rising spot prices, the Saudis cut to 8.5 million b/d in the spring of 1979 specifically to make room in the market for the return of oil from Iran's new Islamic regime. The rise in oil prices, however, continued to accelerate sharply.* [ ]

The Iranian proposal won approval because it was beneficial to both Saudi Arabia and Iran. An OPEC delegate recently told Embassy officials in Jakarta that Iran quietly vetted its plan to the Saudis before revealing it to the rest of OPEC to ensure its success. The Saudis could have blocked the accord if they had wanted to continue the price war. From Riyadh's view, however, prices could return to about \$15 per barrel with strict adherence to the guidelines, satisfying most Saudi oil policy objectives. Riyadh probably also believes it has taught other producers that production restraint is preferable to a price war and probably saw the proposal as a way to deflate strong opposition to its policies within OPEC, especially from Iran and Libya. [ ]

Iran, for its part, will improve its financial position if the agreement holds. Iran's oil minister indicated that Tehran brokered the accord to reverse the downward trend in oil prices and give OPEC some breathing room to devise a future strategy. Iran probably believes that it has gained in stature within OPEC and probably will strive to undermine Riyadh's influence by portraying the Saudi-led strategy to increase OPEC's market share as a major blunder. [ ]

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**Implications for the Oil Market**

The average world oil price climbed to almost \$14 per barrel in early September and will probably hover around \$15 per barrel if producers adhere to the agreement. In our view, however, the oil market will remain volatile through the winter. The OPEC accord is viewed primarily as a stopgap measure to shore up prices, and some members almost certainly will be dissatisfied with quota obligations after October. Some OPEC sources indicate that the organization will seek a "fair share" of the market of at least 18 million b/d during the winter heating season, compared with the current quota of 16.7 million b/d. The oil market will be especially vulnerable to downward price pressures if market factors fail to support higher OPEC production. [ ]

**Demand Factors.** Most industry forecasters look for non-Communist oil consumption to increase at an annual rate of 2 to 3 percent during the winter. Consumption growth may fall below expectations, however, especially if economic growth in the industrial countries falters. Under normal circumstances, we would expect a seasonal inventory drawdown in the fourth quarter of less than 1 million b/d. It could prove much larger this year, however, because of the unusually large inventories accumulated in recent months. Indeed, we believe inventories in August, for example, rose by as much as 2 million b/d faster than expected. [ ]

**Supply Pressure.** A rebound in non-OPEC output during the remainder of the year will also keep downward pressure on prices. We expect increases in output from non-OPEC producers—mainly from completion of maintenance programs in the North Sea—in the coming months to more than offset voluntary production cuts from non-OPEC LDCs. We expect total non-OPEC output to rise by as much as 500,000 b/d from current levels to 27 million b/d (see inset, "Prospects for Non-OPEC Production" and table 2). [ ]

**Price Outlook.** The burden of price support will remain on OPEC. If OPEC adheres to and extends the production-sharing agreement through 1987, oil prices should average about \$15 per barrel. Should consumption growth falter and OPEC raise crude

**Table 2**  
**Non-Communist Oil Supply**  
**and Demand Balance**

Million b/d

	Total Consump- tion <sup>a</sup>	Inventory Change	Supply		
			Total	Non- OPEC	OPEC
<b>1986</b>	<b>45.9</b>	<b>0.4</b>	<b>46.3</b>	<b>26.8</b>	<b>19.5</b>
1st Qtr	46.7	-0.9	45.8	26.8	19.0
2nd Qtr	44.7	1.8	46.5	26.5	20.0
3rd Qtr <sup>b</sup>	45.5	1.5	47.0	26.8	20.2
4th Qtr <sup>b</sup>	47.2	-1.7	45.5	27.0	18.5
<b>1985</b>	<b>44.9</b>	<b>-0.6</b>	<b>44.3</b>	<b>27.0</b>	<b>17.3</b>
1st Qtr	46.6	-2.6	44.0	26.3	17.7
2nd Qtr	43.3	0.2	43.5	26.8	16.7
3rd Qtr	43.6	-0.2	43.4	27.3	16.1
4th Qtr	45.9	0.7	46.6	27.6	19.0

<sup>a</sup> Excludes refinery gains.

<sup>b</sup> Assumes OPEC production, including 1.2 million b/d of natural gas liquids, returns to quota level during September and October and average oil prices remain at about \$15 per barrel.

output to recent levels of 20 million b/d, another price war is likely to ensue. If OPEC members force remaining excess crude oil productive capacity—currently another 7 million b/d—onto the market, prices could fall to about \$5 per barrel. If OPEC fails to hold down output, oil prices could remain well below current levels for two years or so, according to some industry analysts. Barring a major oil supply disruption, we do not anticipate that oil prices will rise above \$20 per barrel in the next year or two (see inset, "Near-Term Energy Security"). [ ]

In any event, uncertainties about producer intentions will probably cause considerable price volatility over the near term, similar to what has occurred this year. Indeed, spot prices in 1986 have often fluctuated by as much as \$5 per barrel within a week or so. Such volatility and uncertainty will probably delay oil company exploration and development investment decisions. [ ]

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***Prospects for Non-OPEC Production***

***Cooperating Nations***

- Mexico*** Reiterated offer to cut exports to 1.35 million b/d from last year's level of 1.5 million b/d. Exports in the first half of 1986 were 1.3 million b/d as a result of marketing problems. Sales could increase to 1.4 million b/d in the second half.
- Egypt*** Production has been lower than 700,000 b/d since February. Agreed only to keep output below 900,000 b/d.
- Angola*** Indicated it would consider cooperating, but no amount specified—probably lipservice.
- Malaysia*** Announced it would reduce output by 10 percent, or 50,000 b/d from current production of 510,000 b/d.
- Oman*** Agreed in May to reduce production by 50,000 b/d. May cut back with new OPEC agreement.
- Brunei*** Reportedly may reduce output by 10,000 b/d—amount is insignificant on world market.
- USSR*** Announced it would reduce exports to the West by 100,000 b/d to support OPEC. Sales in fourth quarter typically decline by 200,000 to 300,000 b/d, however, reflecting seasonal domestic demand. We expect no additional reductions in net Communist exports.

***Noncooperating and Undecided Nations***

- Norway*** Announced it will decide whether to cooperate with OPEC by September 1986. Previously indicated it might limit future production increases as a form of cooperation.
- United Kingdom*** Summer maintenance programs brought output to three-year low in June. We expect increases of some 300,000 b/d in next month or so as program ends.
- Canada*** Some high-cost production shut in, but no further reductions likely.
- Australia*** Output fell by about 100,000 b/d this summer because of domestic oil strikes and high tax structure. New tax revision likely to stimulate output by 100,000 b/d.

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### Near-Term Energy Security

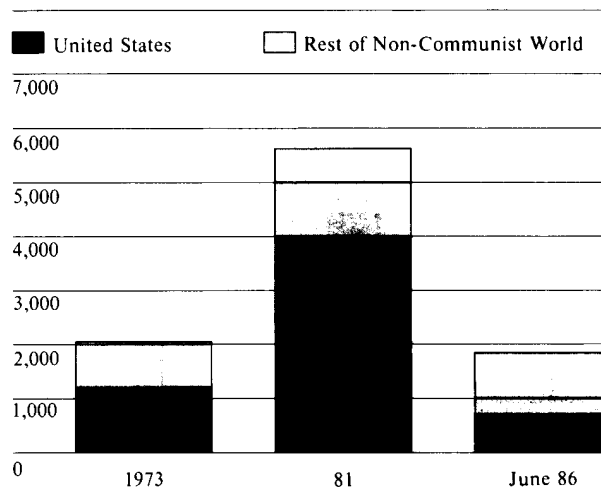
*Increased Iranian military activity could set off a chain of events that would seriously threaten oil supplies from the Persian Gulf and accelerate recent oil price gains. Iran's general mobilization of troops and its vow to end the war by spring 1987 are among signs that Iran is preparing to launch a major ground assault. Iraq already has responded to recent Iranian military preparations by stepping up its campaign against key economic targets including Iran's Sirri Island oil transshipment facility and Khark Island oil terminal. The increasing frequency of Iraq's air-strikes has led Iran to step up its retaliatory strikes against Persian Gulf shipping. Moreover, Tehran, in our view, was behind the recent terrorist attacks on Kuwait's oil export system and is capable of additional terrorist actions or even launching missiles against oil facilities on the Arabian Peninsula. Indeed, Iran recently threatened to deliver "decisive blows" against oil production and export facilities of Arab nations it believes are providing aid to Iraq.*

*Market fears of a Persian Gulf oil supply disruption have ebbed in the face of a large buildup in surplus productive capacity and this year's plunge in oil prices. Nonetheless, of the roughly 8 million b/d of surplus crude oil productive capacity worldwide, only about 3 million b/d is outside the Persian Gulf—mostly in Venezuela, Libya, and Nigeria. Within the Gulf, the availability of Saudi supplies remains the key to avoiding a major disruption. Any loss of supplies that does not affect Saudi capacity could be offset by Riyadh and the surplus outside the Gulf. If Saudi exports were seriously affected, however, the market would be confronted with a net supply short-fall and renewed upward oil price pressure.*

### The Issue of Market Control

Over time we expect that current low prices will encourage a resurgence of conditions allowing Persian Gulf oil producers to position themselves to control the market. Uncertainties about the extent of the

**Figure 3**  
**Non-Communist World: Active Drilling Rigs**

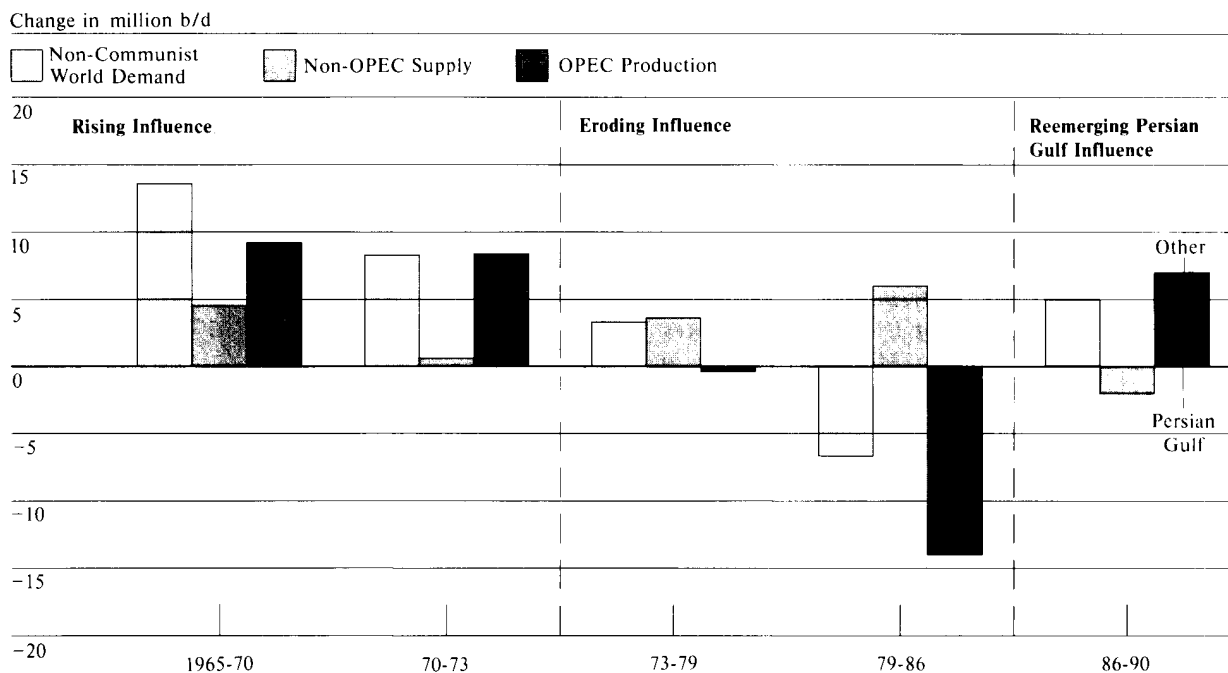


expected recovery in oil demand, the decline in non-OPEC supplies, and the long-term intentions of Gulf producers, however, make it difficult to forecast if this potential will be effectively exploited. Most industry forecasts predict that low prices will spur demand, slow supply development, and erode the supply cushion by the early 1990s.

We already have signs of a shift in supply. In particular, productive capacity in non-OPEC countries is beginning to decline, and development and drilling in high-cost oil-producing areas—like the United States—have slowed markedly in the wake of the sharp drop in oil prices (see figure 3). This phenomenon is also prevalent in some OPEC states outside the Middle East like Indonesia, Venezuela, and Algeria, where exploration and development budgets have been slashed and plans for additional productive capacity have been shelved.

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**Figure 4**  
**Oil Producers: Shifting Market Positions**

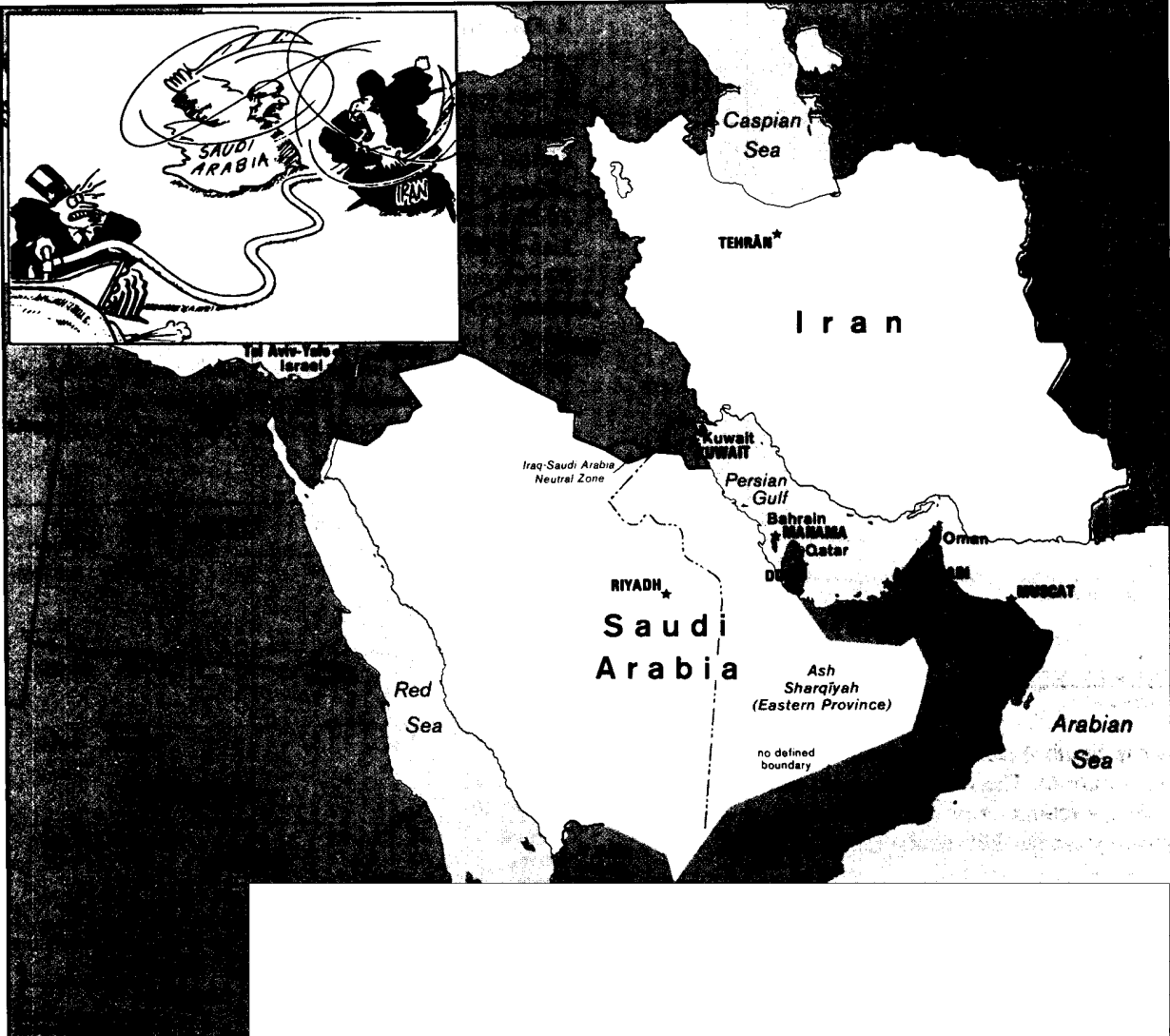


Demand patterns are also shifting. Although the momentum toward greater technological efficiency and less energy-intensive services is still strong and will probably continue to slow demand growth in the future, the low oil prices of 1986 have spurred oil demand. If prices remain about \$15 per barrel for the next several years, some industry forecasters project that oil demand would rise by as much as 5 million b/d, non-OPEC supplies would drop by about 2 million b/d, and demand for OPEC oil could reach roughly 24 million b/d by the early 1990s (see figure 4).

As the oil market tightens, the concentration of supplies and productive capacity will probably be in the hands of a few Persian Gulf producers. Saudi Arabia and Iran are likely to have the powerful combination of oil wealth and regional military strength to be particularly influential in Persian Gulf matters (see figure 5). According to industry estimates, about 60 percent of non-Communist oil reserves are in the Persian Gulf region; 25 percent alone

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Figure 5  
Saudi Arabia and Iran: A Comparison



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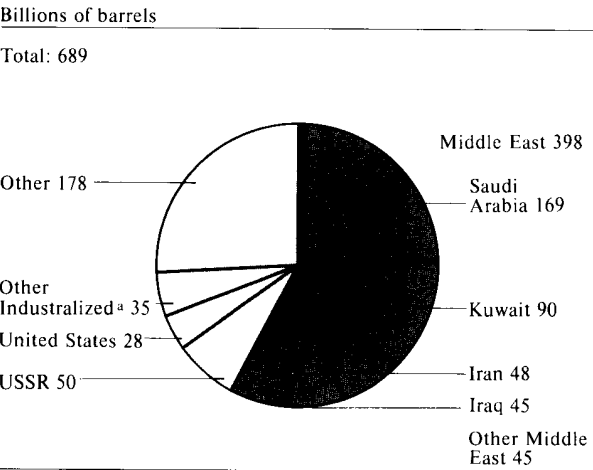
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Figure 6  
World Crude Oil Reserves, 1986



<sup>a</sup> Countries included are Western Europe, Canada, Japan, Australia, and New Zealand.

are in Saudi Arabia and nearly 10 percent are in Iran (see figure 6). These countries also will maintain the greatest volume of productive capacity to adjust output to meet market requirements.

Saudi Arabia—with about 8 million b/d of crude oil productive capacity—historically has maintained the greatest flexibility to adjust production. If Iran wins the war with Iraq in a way that gives it substantial influence over Iraqi oil policy, however, Tehran would have a say in how an additional 2 million b/d of oil is marketed. Tehran's market influence would be even greater if it were able to influence Kuwaiti oil policy—a likely possibility with a major victory in the war. Taken together, Iran, Iraq, and Kuwait have about 7 million b/d of productive capacity and more oil reserves than Saudi Arabia—enough to seriously challenge Riyadh's dominant market position (see inset, "Iran's Potential Oil Market Influence: A Full Victory Scenario"). Moreover, recent moves by Iran to improve production potential in its oilfields with an

*Iran's Potential Oil Market Influence:  
A Full-Victory Scenario*

*A full-scale Iranian victory over Iraq and the establishment of a fundamentalist regime in Baghdad almost certainly would provide Tehran with powerful influence over the region's vast oil resources. In addition to its own resources, Iran would be able to heavily influence those of Iraq, and, possibly, Kuwait. These countries combined hold about 20 percent of non-Communist productive capacity and nearly one-third of non-Communist oil reserves. If this scenario comes to fruition, moreover, Riyadh would be forced to concede some of its oil market power to Tehran, especially if the Saudis believe that their strategic interests were threatened.*

	Iran	Iraq	Kuwait	Total <sup>a</sup>	Saudi Arabia <sup>a</sup>
Current available capacity <sup>b</sup> (million b/d)	3.4	1.9	1.6	6.9 (13)	8.5 (16)
Potential capacity <sup>c</sup> (million b/d)	5	3	3	10 (20)	10 (20)
1986 crude oil production <sup>d</sup> (million b/d)	2.2	1.8	1.5	5.5 (12)	5 (11)
Crude oil reserves (billion barrels)	48	45	90	183 (29)	169 (26)

<sup>a</sup> Number in parentheses is the percent share of the non-Communist total.  
<sup>b</sup> 90-day capacity.  
<sup>c</sup> CIA estimate.  
<sup>d</sup> January-August.

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extensive and ambitious gas reinjection plan could raise Tehran's productive capacity by roughly 2 million b/d to about 5 million b/d by 1990—a level nearly commensurate with its prewar capability.

#### Oil Policy Struggle:

##### Saudi Arabia Versus Iran

In our view, the recent OPEC agreement represents a temporary detente between Saudi Arabia and Iran on the oil policy issue. As price pressures confront OPEC in the future, however, friction between Riyadh and Tehran undoubtedly will reemerge, similar to confrontations that have surfaced in the past. As both countries exert greater influence, intentions regarding oil supplies could become more closely linked to Arab and Islamic political causes.

As long as the Iran-Iraq war continues, we believe the Saudis will have the upper hand and will lead OPEC along a moderate oil price strategy. A major Iranian victory in the war—a possibility within the next several years—would change the balance of power in the Gulf region, however, and could portend a sharp shift in alliances. This would force Riyadh to become more conciliatory to Iranian oil policy objectives, which we believe would favor much higher oil prices than would otherwise be the case. Moreover, merely an end to the war, rather than a major victory, may be enough for increased Iranian influence in OPEC decisionmaking. In our view, longer term supply and demand trends and a rebuilding of Iranian oil productive capacity will provide Tehran with the increased market influence to confront Riyadh again.

Conflict between Saudi Arabia and Iran, however, is not limited to oil policy. Riyadh and Tehran have long been rivals for political influence over the smaller Gulf states, and competition is likely to continue regardless of oil market developments or the leadership in these countries. Antagonism has been sharpened by the determination of the clerical regime in Iran to export its revolutionary Islamic ideals to Gulf Shias and by its eventual goal of overthrowing the Gulf monarchies. By financially backing Iraq in its war with Iran and pursuing oil policies that have hurt the Iranian economy, Riyadh has sharpened Tehran's sense of grievance.

While Riyadh and Tehran are likely to have stronger influence on the oil market, their respective oil policy objectives are not always consistent because of their greatly differing economic needs and political goals. How this rivalry plays itself out will largely determine the shape of the oil market over the next five years (see inset, "Conditions Affecting Persian Gulf Oil Market Power").

*If the Saudis Stay in Control.* The Saudis, in our view, are mainly interested in securing a long-term market for their vast oil resources with relatively low but steadily rising prices. They will probably attempt to maintain prices in the \$15 to \$20 per barrel range over the next several years. We believe that Riyadh will probably continue to strive to lead a coalition of Persian Gulf producers—including Iraq, Kuwait, Qatar, and the UAE—toward that end. In our judgment, the Saudis also want to:

- Establish a stable energy environment with rising oil demand.
- Raise earnings from oil sales.
- Maintain their position as the largest oil producer in the Persian Gulf region and the non-Communist's largest oil exporter.
- Avoid direct confrontation with other producers whose strategic interests are tied to Riyadh.
- Bolster Saudi Arabia's political influence and diplomatic stature.

The Saudis, of all major exporters, historically have had the most sophisticated view of oil market developments. We believe that Riyadh will continue to take into account the status of world economies, the changing structure of the oil market, and the need to compromise when necessary with Iran to best serve its own interests. At the same time, we believe Riyadh will not hesitate to use its excess capacity to force other producers to accept its price goals.

At prices in the \$15 to \$20 per barrel range, the Saudis would be in the best position to capture the bulk of the anticipated increase in demand. Saudi output might rise to about 7 million b/d by 1990, and annual oil revenues would climb from recent levels of about \$20 billion to \$40-50 billion, the amount needed

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**Conditions Affecting Persian Gulf Oil Market Power**

**Continued Saudi Dominance**

- *Iraq wins the war.*
- *Iran-Iraq war continues; production from both countries increases.*
- *Successor regime to Khomeini is more moderate or focuses more on domestic affairs than on international oil policy.*
- *Weak market conditions prevail. Saudis maintain large surplus capacity and retain position as world's largest exporter.*
- *Iran becomes isolated in its oil strategy pursuits; Arab producers align with Riyadh.*

**Greater Iranian Influence**

- *Tehran scores a major victory in war. Iraqi exports restricted.*
- *Saudi excess capacity severely reduced as a result of terrorism or sabotage.*
- *Current Saudi regime falls, replaced by more passive government.*
- *Tight market conditions emerge with limited surplus capacity in Gulf. Iran continues to increase excess productive capacity; challenges Saudi Arabia as largest exporter by raising capacity well above prewar levels.*
- *Other Arab producers favor higher prices and align with Iran.*

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to balance the current Saudi budget. In this case, the Saudis would remain the world's largest oil exporter. Riyadh's improved ability to disperse foreign aid as petrodollar diplomacy at these revenue levels would help neutralize potential threats from the outside—Syria, Iran, and Iraq—and the inside—Eastern Province Shias. On the domestic front, the higher oil revenues would [redacted] ease domestic discomfort over the relative sacrifices forced by lower oil earnings of the past few years. [redacted]

**Effects of Stronger Iranian Influence.** If the course of the Iran-Iraq war turns in its favor, Tehran could exert a stronger influence over the future oil market. Iran's oil policy objectives contrast sharply with Saudi Arabia's, in our view. While they probably recognize the need to take into account underlying market conditions in choosing an oil strategy, the Iranians nonetheless would be more apt to develop a unilateral strategy that would have undesirable consequences for many Western interests. In general, Tehran would seek to:

- Establish a dominance in the Gulf.
- Keep oil prices high to rebuild the postwar economy.

- Maintain a stable production level and force down production in Saudi Arabia.
- Intimidate other Persian Gulf exporters into also lowering production to support high prices.
- Become the Persian Gulf's largest producer and dominant player in OPEC. [redacted]

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In this scenario, Iran probably would attempt to raise oil prices to near \$30 per barrel or even higher in as short a time as possible. Indeed, Tehran has consistently pushed for higher prices and indicated it would be unsatisfied with a price below the old benchmark price of \$28 per barrel. Iran probably would restrict Iraqi exports if it gained unconditional victory over Baghdad but would also have to coerce Saudi Arabia and other Arab producers to hold down output to support a price of \$30 per barrel. Iran would also be in a better position to threaten the West with oil supply disruptions. [redacted]

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An unconditional victory over Iraq would substantially increase Tehran's influence in Gulf affairs and within OPEC, making them a powerful force with which Riyadh would have to reckon. In our view,

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Tehran believes the West has exploited the oil-producing LDCs in the past and is taking advantage of the current low oil prices. With prices at \$30 per barrel, Tehran would earn about \$20 billion annually—more than twice the revenues it will earn this year. With oil revenues at this level Iran could more than meet its import requirements for its development program. In our view, Tehran probably would use its enhanced oil market power to try to export its radical Islamic fundamentalism.

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**Implications for the West**

The sharp cutback in exploration activities—because of low and uncertain oil prices—will have an impact well after prices begin to rise and exploration is once again commercially attractive. The failure to add sufficiently to the reserve base for several years will probably mean non-OPEC output will suffer well into the 1990s. This unavoidable subtraction from potential non-OPEC supplies, coupled with a significant new increment in oil demand, opens a new window of vulnerability in Western oil supplies in the next decade.

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Depending on the scale of a potential Iranian victory and the degree of cohesion Tehran could muster within OPEC, oil prices could increase sharply and quickly. The political gains that would flow to an economically and militarily stronger Tehran from such a turn of events would clearly weaken US security interests in the region and greatly complicate the pursuit of US policy goals. In our view, if Tehran gains a strong say in how Iraqi oil is marketed, it would assume a substantially stronger—and perhaps determining—role in oil market conditions.

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AID	ADDRESS	120/170/0050/0024841 ALAN JACOBS DIRECTOR, OFFICE OF ENERGY BUREAU FOR SCIENCE AND TECHNOLOGY AID 506 SA-18	1	128	128
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CIA	ADDRESS	001/170/0012/0045005 ROBERT M GATES DEPUTY DIRECTOR OF CENTRAL INTELLIGENCE	1	136	136
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CIA	ADDRESS	:		1	214	214
CIA	ADDRESS	:		2	215	216

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IRANIAN RIVALRY

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CIA	ADDRESS	6	217	222
CIA	ADDRESS	1	223	223
CIA	ADDRESS	5	224	228
CIA	ADDRESS	4	229	232
CIA	ADDRESS	1	233	233
CIA	ADDRESS	27	234	260

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IRANIAN RIVALRY

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DATE OF RUN : 09/12/86

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IRANIAN RIVALRY

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CIA	ADDRESS		1	281	281
CIA	ADDRESS		1	282	282

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IRANIAN RIVALRY [REDACTED]

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IRANIAN RIVALRY

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IRANIAN RIVALRY

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CIA	ADDRESS	:		1	303	303
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IRANIAN RIVALRY

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CIA	ADDRESS	:		2	425	426
CIA	ADDRESS	:		1	427	427
CIA	ADDRESS	:		1	428	428

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IRANIAN RIVALRY

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IRANIAN RIVALRY

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CIA	ADDRESS	:		1	441	441
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CIA	ADDRESS	:		1	443	443
CIA	ADDRESS	:		1	444	444
CIA	ADDRESS	:		1	445	445

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